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STATE OF WASHINGTON
DEPARTMENT OF INFORMATION SERVICES
Olympia, Washington 98504-2445

February 5, 1998

Honorable Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street N.W., Room 222
Washington, D.C. 20554

RE: CC Docket 96-45 - Reply Comments on Universal Service (Report to Congress) In Response to Public Notice DA 98-63 Issued January 14, 1998

Dear Secretary Salas:

Enclosed are an original and 11 copies of the Reply Comments of the Washington State Department of Information Services to be filed in the above captioned proceeding.

If you have any questions, please contact me at (360) 902-2981.

Sincerely,

David Danner
Senior Policy Advisor

Enclosures

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List ABCDE

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket 96-45
Federal –State Joint Board on	)	DA 98-63
Universal Service	)	(Report to Congress)
	)	

REPLY COMMENTS OF THE WASHINGTON STATE DEPARTMENT OF INFORMATION SERVICES

The Washington State Department of Information Services ("DIS") submits these Reply Comments to provide further information on matters raised by various parties in response to the Commission's January 5, 1998, Public Notice in the above-captioned proceeding. Specifically, DIS addresses the consequences of the Federal Communications Commission's Fourth Order on Reconsideration in CC Docket No. 95-45, adopted December 30, 1997 ("Fourth Order"), on telecommunications and information services provided by state governments to public sector entities, including schools and libraries.

In its Fourth Order, the Commission clarified several issues first addressed in its May 8, 1997, Report and Order implementing the universal service discount program for schools and libraries. Among other things, it determined that state telecommunications networks would not be eligible to receive direct reimbursement from the Universal Service Fund ("USF") for telecommunications services provided to schools and libraries. The Commission also determined that schools and libraries that receive state-provided telecommunications services cannot receive discounts for "value added" integration of these services, even though they may receive discounts on such services when provided directly by a private provider.

In their Comments, the National Association of State Telecommunications Directors ("NASTD"), of which DIS is a member, and the Florida Department of Management Services, raised concerns that the Fourth Order precludes schools and libraries from obtaining discounts on the significant administrative costs included in their state-provided services. They also made clear that the administrative detail imposed by the Fourth Order – requiring the state network to match the appropriate USF discount percentage to the individual eligible entity – is overly burdensome to current billing processes.

The Fourth Order creates similar problems for the State of Washington, and, indeed, threatens to undo its decade-long effort to promote efficiencies in public-sector telecommunications. By denying the state the ability to obtain discounts directly from the USF, the Commission has subjected Washington State to a tremendous administrative burden to comply with the discount program. These significant administrative costs must be passed on to the schools and libraries it serves. By denying Washington's schools and libraries the ability to obtain discounts for legitimate costs associated with the state's aggregation of telecommunications services, the Commission has made these services less attractive to schools and libraries.

As a result, the Commission has created disincentives for Washington's schools and libraries to use state-aggregated telecommunications services, even though the costs of state services would be considerably lower *but for* the greater discounts that flow to the private carriers under the current rules. This not only creates added pressure on the USF, since discounts to schools will be based on the larger costs of services provided directly by private companies, but by potentially draining the state network's customer base of schools and libraries, it also reduces the volume purchasing power of the state and raises the costs of telecommunications services for all state agencies, local governments, public universities, and other public entities in Washington.

The Commission should make Congress aware of the unintended consequences of its Fourth Order in states such as Washington, and communicate to Congress its intent to resolve these problems. First, it should signal its intent to revisit its narrow definition of "advanced services" under Section 254 to include those services whereby the state networks integrate and add significant value to service elements acquired from carriers and other product and service providers. Alternatively, the Commission should grant Washington's state network and similar state networks a waiver from the strict definition of telecommunications carrier for purposes of the schools and library program. Second, the Commission should declare that state networks are eligible to receive discounts for services provided to K-12 schools and public libraries directly from the USF based on established rates.

A. Washington State Efforts in Promoting Efficiencies in the Purchase and Use of Telecommunications by the Public Sector.

For more than a decade, Washington State has been committed to developing sound policies to guide its acquisition and use of information and telecommunications services. State and local government purchases of telecommunications technologies and services exceed $600 million annually in Washington State, and policy makers have made it a priority to ensure that the state takes advantage of its leverage as a volume purchaser of telecommunications services, and to coordinate infrastructure development to ensure interoperability and avoid costly duplication of facilities and networks.

In 1987, the Legislature created the Department of Information Services as a cabinet-level Washington State agency responsible for providing computing and telecommunications services to state agencies and local governments, and for developing policies to promote the efficient use of information technology within Washington State. DIS operates pursuant to Rev. Code Wash. 43.105.

Through leveraged competition, economies of scale, and value-added integration of private sector products and services, DIS' telecommunications services are provided to state agencies, local governments, public schools, colleges, universities, libraries, and health care providers. By law, it does not provide services to the private sector. DIS is a discretionary provider, meaning that no public entity is required to use DIS services. For this reason, DIS services must be priced competitively with comparable services from private providers. In fact, in all areas, its costs are generally far below those which public entities can obtain directly from private carriers.

DIS has been especially focused on providing cost-effective advanced telecommunications services to the educational community, including schools and libraries. Washington State is a pioneer in providing its education communities with advanced, integrated network services, including long distance, Centrex, multi-sector intranet, Internet access, and interactive switched video services.

1. The K-20 Educational Network.

In 1996, the Legislature authorized the development of the "K-20 Educational Telecommunications Network," to provide universities, colleges, public libraries, and each of the state's 296 public school districts – urban and rural, large and small – with advanced telecommunications services. In establishing the network, the Legislature stated its intent "to make maximum use of a common telecommunications backbone network in building and expanding education technology systems. Therefore, coordinated policy and planning to ensure program quality, interoperability, and efficient service delivery are the highest priority of the legislature."[1]

The K-20 Network was designed with the guidance and participation of the entire education community. Consistent with state policy, this multi-sector collaboration sought to avoid costly, duplicative and overlapping infrastructure; assure interoperability between the education sectors and their programs; and achieve maximum leverage in obtaining the required components of the network. Examples of network services provided by the K-20 Network that go beyond basic telecommunication services include:

- An "education intranet" that provides high-performance, low-overhead delivery of Internet traffic between the state's education institutions without the necessity to route the traffic through the national Internet backbone, thereby avoiding significant but unnecessary transport costs. Where network traffic needs to flow to and from the national Internet backbone for accessing locations outside the state, it is routed though a small number of high-capacity gateways to achieve additional efficiencies. Lower cost and higher performance result from this highly leveraged, shared network approach.
- Switched ISDN services for two-way interactive video. Point-to-point and multi-point connections allow K-12 schools to connect with each other and with community college and higher education institutions. Since these kinds of services are not currently available in many Washington communities, many K-12 schools would not have access to these services except for the K-20 Network.[2]

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[1] Rev. Code. Wash. 28D.02.005.

[2] DIS' efforts in integrating products and services supplied by a variety of telecommunication carriers and equipment suppliers have played an important role in bringing cost-effective, advanced services to many schools in rural communities that would otherwise be unable to obtain them. For example, the interactive video services that can link rural students with college professors in urban centers are provided through the switched ISDN services of the K-20 Network. Such services are simply not commercially available in rural Washington.

The K-20 Network employs leveraged competition to purchase local and interexchange transport services from carriers including US WEST, AT&T, Sprint, and GTE. The network also employs switching equipment obtained from Lucent, Nortel, Cisco, GTE, US WEST and others to aggregate and switch network traffic through regional nodes of the statewide backbone network.

2. Other DIS Services.

In addition to the highly-visible K-20 network project currently under way in Washington, DIS provides long distance, local telephone service, Centrex, and other services to public entities, including schools and libraries. Currently, schools and libraries pay for the various services provided by DIS through rates established to reflect the actual cost of providing service.[3] Leased circuit, equipment, maintenance and operations costs are elements of the network services that are recovered in these rates, just as they are in the rates of any common carrier. These rates are standard for all users of the network, including not just K-12 schools and libraries but higher education as well.

The state network in Washington, through its ability to aggregate demand and provide value-added components, provides the lowest prediscount pricing available in the market for most public organizations. Today, prior to e-rate considerations, more than 120 school districts and libraries have made a business decision to utilize the state network in order to take advantage of value-added services at competitive rates.

The state network in Washington adds value to basic carrier services in a variety of ways. The lower rates that carriers charge the state network are not solely based on volume purchasing leverage. In varying degrees, depending on the service, the state network may collaborate with carriers to assume responsibility for some aspects of service delivery as a way to further reduce costs and/or tailor services to better fit the business needs of public organizations. Additionally, the state network may integrate service elements from several carriers by employing switches or other electronics to produce a tailored service to address statewide requirements.

B. The Fourth Report Imposes Heavy Administrative Burdens on State Telecommunications Networks While Limiting Their Ability to Recover Fair Discounts on Their Costs.

In its May 8 Order, the Commission correctly noted that because state telecommunications networks do not serve private companies, they would not be deemed resellers and therefore not be required to pay into the USF.[4] It noted, too, that it would require such networks to "keep and retain careful records of how they have allocated the costs of shared facilities in order to charge eligible schools and libraries the appropriate amounts."[5] These records need reflect only "reasonable approximations of cost allocations ... sufficient to deter significant abuse."[6]

Based on the Commission's May 8 Order, DIS anticipated that it would be treated as a service provider whose customers could receive appropriate discounts based on the bills they receive from DIS for the services ordered. This would require schools and libraries to complete Forms 470 and 471, and DIS to apply for direct reimbursement for those discounts. This arrangement would have been administratively workable for both DIS and the schools and libraries it served.

In the Fourth Report, however, the Commission stated (at para. 183) that

> with respect to telecommunications, state telecommunications networks only will be permitted to pass on discounts for such services to eligible schools and libraries, but will

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[3] By statute, DIS operates on a full cost-recovery basis. It does not receive legislative appropriations for its services.

[4] Paragraph 800 of the Commission's May 8, 1997, Order, states:

> government entities that purchase telecommunications services in bulk on behalf of themeselves, e.g., state networks for schools and libraries, will not be considered "other providers of telecommunications" that will be required to contribute. Such government entities would be purchasing services for local or state governments or related agencies. Therefore we find that such government agencies serve only their internal needs and should not be required to contribute.

[5] Id. at para. 569.

[6] Id. at para. 570.

> not … be able to receive direct reimbursement from the universal service support mechanism for providing such services. We conclude that a state telecommunications network itself will not qualify for discounts on telecommunications.

The Commission stated that because state networks do not meet the statutory definition of "telecommunications carrier," they are not eligible for direct reimbursement for services other than advanced services. Moreover, because they are not school and libraries, they must pass any discounts directly on to the schools and libraries they serve.

In other words, except for Internet Services, the Fourth Order stipulates that only those telecommunication services purchased directly from carriers – and not the significant value added to these services by state networks – are eligible for USF discounts, and only carriers may obtain discounts directly from the USF. Because the value-added portion of the state network rate is not discountable, however, one of two possible outcomes results:

- The partially discounted state network rate may exceed the fully discounted rate available directly from a carrier causing the school to leave the state network with the result that: 1) both the school and the USF pay more than they would have if the state network rate were fully discounted; 2) the school may lose technical, operational, and programmatic benefits associated with participation in the state network; and 3) the state network loses some measure of purchasing leverage and economies of scale such that all participating public organizations are negatively impacted.
- The partially discounted state network rate may still be lower than the fully discounted rate available directly from a carrier, in which case the school will likely remain with the state network. However, in this case the school would pay more than they would have if the state network rate were fully discounted; and all of the parties – including the carriers supplying services to the state network – are burdened with excessive and unnecessary administrative

processes resulting from the analysis and record keeping required to obtain USF discounts through the carriers.

These are discussed below.

1. The FCC Incorrectly Characterizes Value Added by State Networks as Minimal.

The Fourth Order on Reconsideration incorrectly assumes that all cost elements in a state network rate are either attributable to carrier charges or minor state administrative charges. In fact, state network rates contain cost elements reflecting value-added components and, in some cases, service delivery responsibilities that are shared with carriers. For example, state network value-added service components to *Centrex* service include:

- analysis of subscriber requirements and development of appropriate service orders
- an automated system for service order processing
- project management support for new service initiation
- a single point of contact for subscribers regardless of the particular carrier involved in service provision
- performance of on-line service management functions such as line feature changes
- a billing system that generates simple, easy to understand statements and billing detail that is tailored to meet the subscriber needs
- a 24 x 7 help desk that provides problem resolution support for subscribers
- network performance monitoring and technical support for problem resolution
- optional access to state network long distance services
- optional access to cost-effective voice messaging and other enhanced services that may be of value to schools and libraries (recognizing that some service options may not be eligible for USF discounts)

Similarly, for long distance services, DIS procures telecommunications services from Sprint, US WEST, GTE, and AT&T and combines them in the state network to produce integrated long distance services for public organizations. Currently, subscribers use the state network to place in excess of 2 million long distance calls per month, totaling about 10 million call minutes. In addition to many of the value-added elements outlined in the Centrex detail above, the long distance value-added elements provided by the state include:

- carrier-class switching infrastructure and related facilities are used to aggregate long distance traffic from more than 300 physical locations serving 500 public organizations of which 120 are school districts and libraries
- network design and engineering
- network operation and management

Indeed, part of the justification for larger discounts from carriers is attributable to the fact that the carriers have only the state network organization to deal with for order processing, billing, and problem resolution – a single interface rather than needing to deal directly with hundreds of individual public organizations.

The Commission's Fourth Order minimizes the role that state networks play in providing telecommunications services. It states at Paragraph 182 that state networks should be treated as consortia which may pass through the applicable discounts from the telecommunications carriers to the eligible schools and libraries. However, this ignores that Washington's state network is different from other consortia which simply act as "buyers" because the state contributes significant value-added service components that may account for more than 20 percent of the users' costs, and which clearly exceed the costs associated with a simple "buyers' consortium." By treating all state networks as mere "buyers' consortia," the FCC has arbitrarily limited the ability of the schools and libraries to realize the full benefit of available discounts.

2. The Fourth Order Imposes Undue Administrative Burdens on State Networks.

Paragraph 189 of the Fourth Order recognizes that "...even if [state networks] were able to receive direct reimbursement from the support mechanisms for providing telecommunications, state telecommunications networks would still need to determine which entities are eligible for discounts and the discount rate to which each eligible entity is entitled." DIS does not disagree with this assessment. In fact, DIS has the mechanisms in place to make the discount determinations and apply them. But that is a far less burdensome effort than what has been imposed on state networks by making them split out their rates into portions attributable to any one carrier, any equipment vendor and the state's value-added piece. Such an onus unduly burdens the state networks and prevents them from realizing the same kind of full cost recovery is afforded to the telecommunications carriers under current interpretation. This detrimental treatment of the state network is not justified by any apparent benefit to either the schools and libraries or the USF.

Even if DIS were to undertake the enormous effort to segregate these costs to the degree required by the Commission, the costs of doing do would have to be added to the rates charged to the customers of the state network. As a result, the cost benefits of volume purchasing and state value-added services would be lessened. Indeed, DIS expect that the costs of telecommunications services for all state agencies, local governments, universities, and others will increase as the state faces attrition of its customer base and loses its corresponding volume purchasing power. Moreover, if schools and libraries turn away from the lower-cost state network in search of larger subsidies elsewhere, they risk procuring services that, although fully discounted, may not be interoperable with other state services or which are duplicative of state infrastructure.

C. The Fourth Order Contains Disincentives to Schools' Participation in State Networks, and Will Increase Demands on the Universal Service Fund.

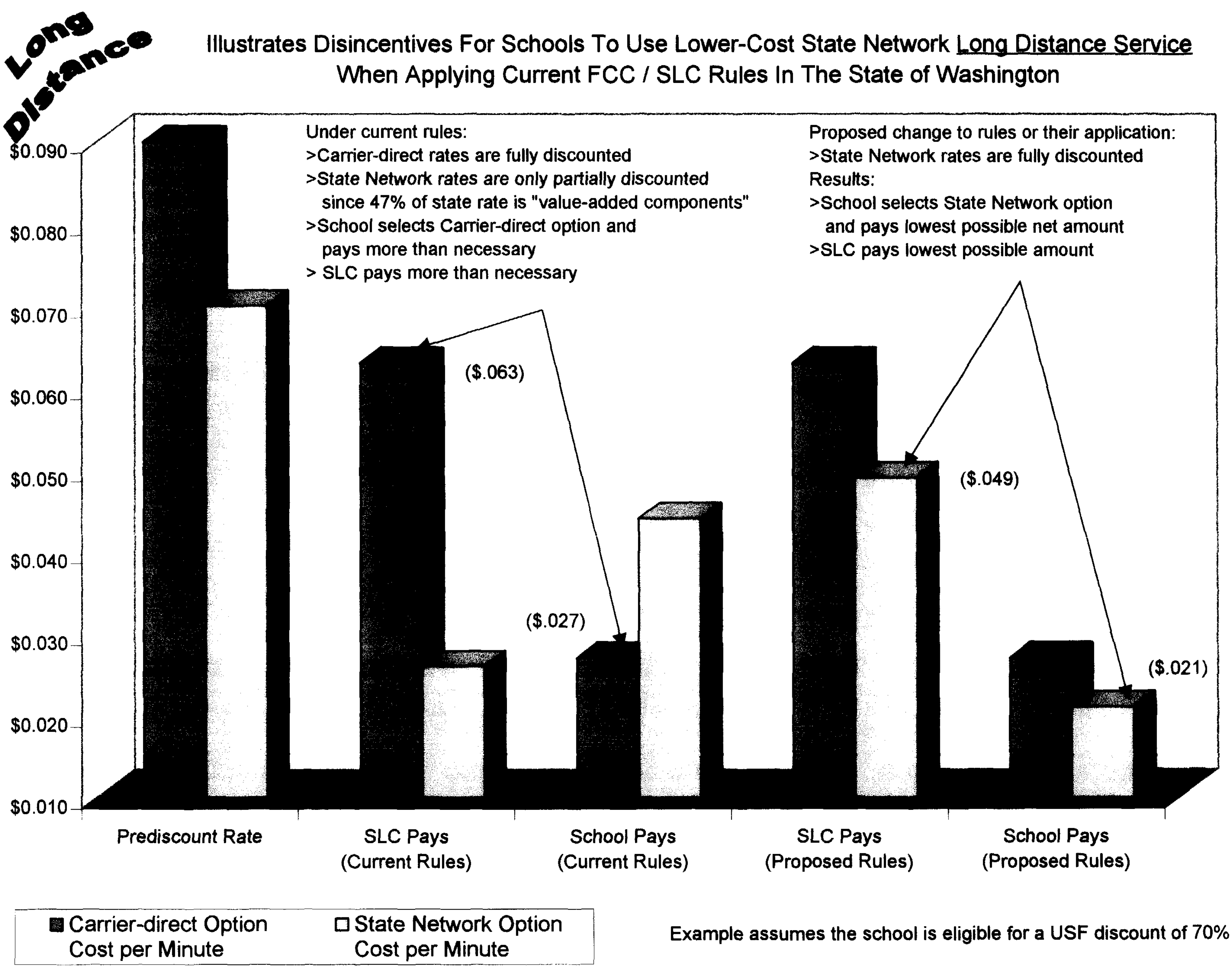
As noted above, DIS services are discretionary. Schools and libraries are free to choose whether to participate in any DIS networks or procure services directly from any other provider. Currently, DIS' services and prices are attractive enough to maintain a large customer base among schools and libraries.

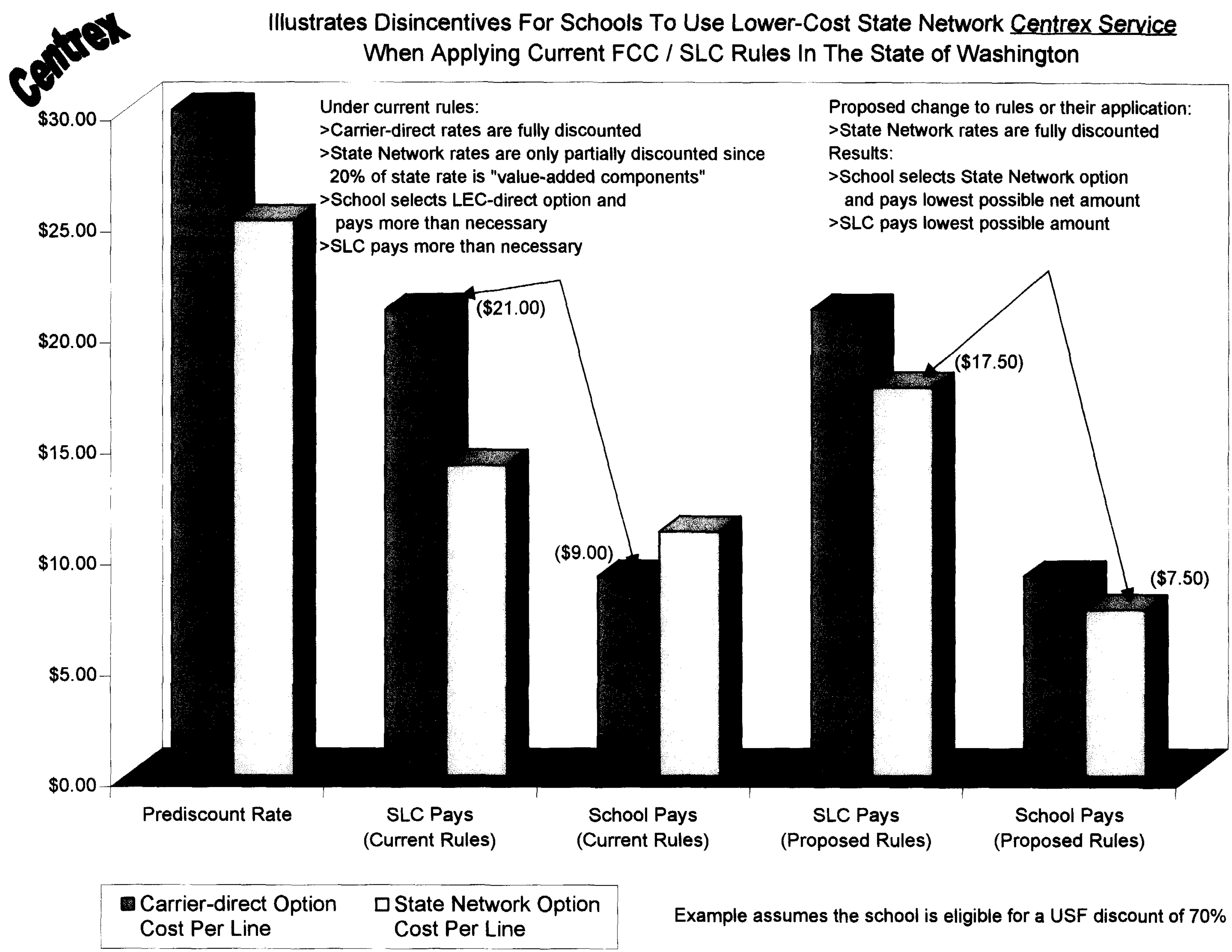
However, by allowing private carriers and other service providers to include their administrative overhead, aggregation costs, and other value added to their standard telecommunications rates for purposes of USF discounts, while denying the same ability to state networks, the Commission allows schools and libraries to discount a higher percentage of the private carriers' costs compared to those of state networks. This gives schools an economic disincentive to stay with the state networks, despite their lower costs.

The attached graphs illustrate these disincentives. Because current rules do not allow schools or libraries to recover discounts on the value added by state networks, these users will be attracted to higher-cost services where they can be assured of discounts on 100 percent of the services provided. This will also result in higher costs to both the USF and the schools and libraries. And because the effect of the Order is to encourage migration away from the lower-cost state network services to higher-cost private services to which discounts can be fully applied, the discounts paid by the USF will be based on substantially higher numbers. This undercuts the very intent of the Telecommunications Act of 1996 and the Commission's May 8 Order to promote efficiencies in the school's use of technology. By contrast, as the graphs show, both the USF and schools and libraries would benefit from the Commission allowing full discounts on rates for state network services.

D. The Commission Should Revisit Its Definition of "Advanced Services" in the Fourth Order to Include Aggregated and Value-Added Services by State Networks.

The Commission should revisit its current classifications of "telecommunications services" and "advanced services." Specifically, Section 254(c)(3) states that "in addition to the services included in the definition of universal service under [Section 25(c)(1)], the Commission may designate additional services for such support mechanisms for schools and libraries ... for the purposes of [Section 254(h)]." Section 254(h)(2), in turn, states that "[t]he Commission shall establish competitively neutral rules to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for


Long Distance
Illustrates Disincentives For Schools To Use Lower-Cost State Network Long Distance Service
When Applying Current FCC / SLC Rules In The State of Washington
Under current rules:
>Carrier-direct rates are fully discounted
>State Network rates are only partially discounted since 47% of state rate is "value-added components"
>School selects Carrier-direct option and pays more than necessary
> SLC pays more than necessary
Proposed change to rules or their application:
>State Network rates are fully discounted
Results:
>School selects State Network option and pays lowest possible net amount
>SLC pays lowest possible amount
($.063)
($.027)
($.049)
($.021)
$0.090
$0.080
$0.070
$0.060
$0.050
$0.040
$0.030
$0.020
$0.010
Prediscount Rate
SLC Pays (Current Rules)
School Pays (Current Rules)
SLC Pays (Proposed Rules)
School Pays (Proposed Rules)
Carrier-direct Option Cost per Minute
State Network Option Cost per Minute
Example assumes the school is eligible for a USF discount of 70%


Centrex
Illustrates Disincentives For Schools To Use Lower-Cost State Network Centrex Service
When Applying Current FCC / SLC Rules In The State of Washington
Under current rules:
>Carrier-direct rates are fully discounted
>State Network rates are only partially discounted since 20% of state rate is "value-added components"
>School selects LEC-direct option and pays more than necessary
>SLC pays more than necessary
Proposed change to rules or their application:
>State Network rates are fully discounted
Results:
>School selects State Network option and pays lowest possible net amount
>SLC pays lowest possible amount
($21.00)
($9.00)
($17.50)
($7.50)
$30.00
$25.00
$20.00
$15.00
$10.00
$5.00
$0.00
Prediscount Rate
SLC Pays (Current Rules)
School Pays (Current Rules)
SLC Pays (Proposed Rules)
School Pays (Proposed Rules)
Carrier-direct Option Cost Per Line
State Network Option Cost Per Line
Example assumes the school is eligible for a USF discount of 70%

all schools and libraries." As the Commission noted in its May 8 Order and again in the Fourtth Order, these provisions "authorize[ ] the Commission to permit discounts and funding mechanisms to enhance access to advanced services by non-telecommunications providers." [7] Thus, the Commission has considerable leeway in classifying services to which the state adds significant value either as "advanced services" or as a separate category of service for purposes of schools and libraries. Given that the specific aggregated and value-added services are generally not available to schools and libraries from the private carriers in the form provided by the state, such a classification is especially appropriate. For this reason, DIS urges the Commission to determine that the rates for state services be deemed fully eligible for discounts, and that state networks may recover those discounts directly from the USF.

Alternatively, the Commission should revisit or waive applicability of the definition of "telecommunications carrier" to allow state networks to receive direct reimbursement from the USF for all services.

Conclusion

Schools and libraries must be able to take advantage of the lowest available prediscount rate regardless of the fact it may include value-added components of the state network. To accomplish this, the USF discount must be applied against the *complete* state network rate, not just the carrier-supplied portion. This will result in the lowest cost to the school and avoid unnecessary costs to the USF. Additionally, this will allow schools and libraries will be able to remain on the state network and continue to contribute to the purchasing leverage created by all public organizations within a state for their mutual benefit.

[7] May 8 Order, 12 FCC Rcd at 9085; Fourth Order, para. 190.

The current reality is that Washington's state network provides more than just the services of a buyers' consortium, and should rightly be allowed to provide direct discounts for those services. The definition of advanced telecommunications services should not be sliced so thinly as to limit discounts on the very kinds of technology contemplated by the Act. The states that have moved to the forefront by providing advanced services to their education sectors should not be penalized for being the pioneers. Allowing full discounts on the state networks such as Washington's ensures that schools and libraries are able to receive the benefits that Congress enumerated.

Respectfully submitted,

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